EXECUTIVE SECRETARIAT

Routing Slip

TO:

		ACTION	INFO	DATE	INITIAL
1	DCI				
2	DDCI				
3	EXDIR				
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8	DDS&T				
9	Chm/NIC				
10	GC				
11	IG				
12	Compt				
13	D/EEO				
14	D/Pers				
15	D/OEA				
16	C/PAD/OEA				
17	SA/IA				
18	AO/DCI				
19	C/IPD/OIS				
20	NIO/ECON		✓		
21					
22					

SUSPENSE ______________ Date

Remarks:

Executive Secretary

4/13/82

Date

3637 (10-81)

THE WHITE HOUSE
WASHINGTON

Executive Registry
83-2011

CABINET AFFAIRS STAFFING MEMORANDUM

DATE: April 11, 1983 NUMBER: 118619CA DUE BY: ______

SUBJECT: Cabinet Council on Commerce and Trade - Wednesday, April 13, 1983 2:00 P.M. Roosevelt Room

	ACTION	FYI
ALL CABINET MEMBERS	☐	☐
Vice President	☑	☐
State	☑	☐
Treasury	☑	☐
Defense	☐	☑
Attorney General	☑	☐
Interior	☐	☑
Agriculture	☑	☐
Commerce	☑	☐
Labor	☑	☐
HHS	☐	☑
HUD	☐	☑
Transportation	☑	☐
Energy	☑	☐
Education	☐	☑
Counsellor	☑	☐
OMB	☐	☑
CIA	☐	☑
UN	☐	☑
USTR	☑	☐
CEA	☑	☐
CEQ	☐	☐
OSTP	☐	☐
______	☐	☐
______	☐	☐

	ACTION	FYI
Baker	☑	☐
Deaver	☐	☐
Clark	☐	☑
Darman *(For WH Staffing)*	☑	☐
Harper	☑	☐
Jenkins	☐	☑
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CCCT/Gunn	☑	☐
CCEA/Porter	☐	☐
CCFA/Boggs	☐	☐
CCHR/Carleson	☐	☐
CCLP/Uhlmann	☐	☐
CCMA/Bledsoe	☐	☐
CCNRE/Boggs	☐	☐

REMARKS: The Cabinet Council on Commerce and Trade will meet Wednesday, April 13, 1983 at 2:00 P.M. in the Roosevelt Room. Agenda will be DISC Replacement, CM # 282. Agenda and paper are attached.

RETURN TO:

☐ Craig L. Fuller
Assistant to the President
for Cabinet Affairs
456-2823

☑ Becky Norton Dunlop
Director, Office of
Cabinet Affairs
456-2800

DCI
EXEC
REG

THE WHITE HOUSE

WASHINGTON

CABINET COUNCIL ON COMMERCE AND TRADE

April 13, 1983

2:00 p.m.

Roosevelt Room

AGENDA

1. DISC Replacement (CM#282)

DISC REPLACEMENT--OUTSTANDING ISSUES TO BE RESOLVED

Issues

When the CCCT approved the Administration's proposal for a DISC replacement on March 2, several issues were left unresolved, including:

(1) the amount of economic activity that must be undertaken by the foreign sales corporation outside the United States to be both GATT defensible and acceptable to the business community;

(2) whether to give agriculture special treatment because the GATT discipline on agricultural export subsidies is much weaker than the discipline on export subsidies for nonprimary products; and

(3) whether to give small companies additional special treatment even though such treatment would be a technical violation of the GATT.

The Council must now decide whether to approve the attached foreign presence test that has been worked out with the private sector, as well as decide whether to grant agriculture and small business special treatment. If the Council decides in the affirmative, it must authorize the USTR, along with the other members of the DISC Task Force, to negotiate the details on each issue with the private sector to gain maximum support for the Administration's proposal without undercutting its GATT defensibility.

Issue 1: Foreign Presence Requirements

Attachment 1 includes a description of the foreign presence requirements that has been negotiated with private sector interests as represented by ECAT, SCUSE, NFTC, NAM, and the Chamber. Since the proposal does not require that all the economic activity required of the foreign sales corporation to meet the arm's length standard be undertaken overseas (i.e., most of it will be done for the foreign sales corporation on a contract basis by the parent in the United States), an argument could be made by our trading partners that we are not requiring sufficient overseas activity to justify the safe harbor income allocation described in the proposal.

The DISC Task Force believes that the proposal can be defended against such criticism because the foreign sales corporation as a whole (i.e., offshore and onshore) will perform some substantive economic activities, the tax exempt level of income will be small (i.e., 17 percent of combined net profit or 1.35 of gross receipts), and the foreign presence requirements are probably more stringent than those imposed by other governments on their foreign sales corporations under the territorial system. Despite these arguments, the GATT defense may be difficult if our trading partners adamantly contest the proposal in the GATT Council.

Unfortunately, a more stringent set of foreign presence requirements would not be acceptable to the business community.

Recommendation

Approve Attachment 1 and authorize the USTR, along with the Task Force, to work out details and definitions that will satisfy the private sector without undercutting the GATT defensibility of the proposal.

Issue 2: Special Treatment for Agriculture

The agricultural community wants to be excluded from the foreign presence requirements. They argue that agricultural exporters do not have offices overseas. Therefore, any foreign presence requirements will impose a substantial burden on them. They support their bid for an exception on the grounds that the GATT discipline on export subsidies for agricultural (primary) products is not an outright prohibition as is the case with industrial (nonprimary) products. With respect to agriculture, the GATT states only that export subsidies should "...not be applied in a manner which results in that contracting party having more than equitable share of world export trade in that product..." Since "more than an equitable share" has never been defined and GATT Panels have refused to define the concept by precedent (e.g., the wheat flour case), there is as a practical matter no significant, international discipline on agricultural export subsidies.

In light of this lack of international discipline, the agricultural community believes that it does not have to conform to the same GATT standard upon which the Administration's proposal is based. Technically, this opinion is correct. However, we have resisted carving out an exception for agriculture in the belief that such action would have been seen as unfair by the industrial community and would generate opposition to the proposal. It may also exacerbate the U.S.-EC conflict on agricultural export subsidies and may put us in a weaker posture for pressuring the EC to discipline its subsidy practices.

We have now been informed by some contacts on the Hill that special treatment for agriculture is necessary to achieve approval of Congress. Whether such special treatment means that agriculturists can keep their DISCs or that we must devise a more lenient foreign presence standard for agriculture remains to be seen. It's clear that the agricultural community would prefer the latter because the other elements of the proposal (i.e., exemption rather than the current deferral and the forgiveness of existing deferred taxes) represent an improvement over the DISC. This point, however, would have to be negotiated with the private sector in exchange for support for the entire proposal.

Recommendation

Authorize the USTR, along with the DISC Task Force, to negotiate a minimal exception for agriculture only if it is necessary to get the agricultural community to support the proposal wholeheartedly. Before granting such an exception, every effort should be made to get the agricultural community to support the proposal without special treatment.

Issue 3: Small Business

The small business community wants to be excluded from the foreign presence requirements because they are too costly to meet and in most cases would tend to reduce the tax benefit of the DISC for small companies. Such an exemption would technically violate the GATT; however, the violation would be de minimus as small DISCs account for a small portion of all the revenue and income generated by DISCs. For example, in 1980, DISCs with less than $10 million in gross receipts accounted for about 85 percent of all the DISCs, but only 9 percent of all the gross receipts and 12 percent of all the net income generated by all the DISCs. It is now clear that some sort of an exception for small companies will be necessary to get their support. The critical questions are:

(1) how do we define a small company for the purpose of the exception; and

(2) what form should the exception take.

With respect to the latter, it now appears that some form of a lenient foreign presence test will win approval of small business rather than an exception that allows them to keep their DISCs. This approach may make our GATT defense of the exception somewhat easier.

Recommendation

Authorize USTR, along with the DISC Task Force, to negotiate a minimal exception for small companies which will involve more lenient foreign presence requirements. The exception should be narrowly defined so as to include only small companies with small DISCs. Large companies with multiple small DISCs should be excluded from the exception.

Issue 4: Tactics

In working with the private sector, the DISC Task Force has attempted to build a consensus across the entire range of business interests in favor of the Administration's proposal. Our legislative strategy is to send to Congress a proposal which is supported by most segments of the business community. This should minimize the controversy surrounding the proposal, and maximize the chances that a DISC substitute can be enacted this year. The only downside risk associated with this strategy is that we will have precious little flexibility to amend the proposal to neutralize opposition once it is introduced. We will have made all our concessions early in the process; hence, the bill will be essentially unamendable. Nevertheless, we believe this strategy is the only way to go because we are convinced that a battle over DISC will virtually guarantee that no DISC substitute will be enacted or, worse yet, the DISC will be repealed.

Recommendation

Authorize USTR, along with the DISC Task Force, to continue its collaborative strategy for building support for the Administration's proposal, making concessions in the areas outlined above only as necessary to gain wholehearted support.

Attachment

REQUIRED ACTIVITIES OF THE FOREIGN SALES CORPORATION

To be eligible for tax exempt treatment under this proposal, the foreign sales corporation must:

1. maintain an office outside the United States;

2. maintain books and records in that foreign office; 1/

3. have at least one resident director outside the United States; and

4. hold an exclusive or nonexclusive agency agreement, franchise agreement, or distribution license with respect to the product.

In addition, to be eligible for the administrative income allocation rules the following functions must be performed by the foreign sales corporation, or for it on a contract basis, in connection with foreign trading gross receipts:

5. solicit orders from and negotiate contracts with customers;

6. process customer orders; and

7. bill customers and receive payments.

Furthermore, to be eligible for the administrative income allocation rules the foreign corporation must engage in foreign economic processes by satisfying the following three categories of requirements:

Category 1: The foreign sales corporation must participate outside the United States in the solicitation, negotiation, or acceptance of sales. Solicitation includes advertising, direct mail, or other communications to related or unrelated customers or potential customers. Negotiation includes any communication relating to terms of sale. Acceptance means formal legal acceptance.

Category 2: The foreign sales corporation must perform outside the United States activities that give rise to 50% of the costs associated with items 1-5 below, or do substantially all (85%) of two of the following:

1. process customer orders;

2. bill customers or receive payment;

3. engage in advertising and promotion activities;

1/ For purposes of U.S. tax administration and enforcement, it will be necessary for the books and records to be available for examination in the United States.

4. contract for payment of commissions or fees to related or unrelated agents; and

5. assume credit risk, risk of loss from casualty, damage, etc., and foreign exchange risk. 2/

Category 3: The foreign sales corporation must perform substantially all (85%) of the following activities outside the United States:

1. hold board of directors and shareholders meetings;

2. maintain a separate bank account and paid in capital; and

3. disburse dividends, legal fees, board of directors and officers salaries, and accounting fees.

Where the U.S. exporter or the foreign sales corporation sells to a related foreign buyer, the activities in categories 1 and 2 above relate to transactions between the seller and the related foreign buyer.

2/ The assumption of risk implies an additional burden or gain for the foreign corporation than that implied by the normal calculation of combined taxable income. If a foreign corporation chooses to incur these additional risks, an additional adjustment will be made to the income allocated to the foreign corporation to derive that portion of the income that will be exempt from tax. The adjustment will be the subtraction from the foreign corporation's income allocation of 17% of all the losses incurred by the related parties resulting from these risks, and the addition to the foreign corporation's income allocation 17% of all the gains for the related parties from incurring foreign exchange risk.